Petition

81-853

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No. ____

IN THE

Supreme Court of the United States

October Term, 1981

LINCOLN BANK, a corporation,

Petitioner,

vs.

TERRENCE B. GOGGIN, as Trustee of Stabrite Pool Stores, Inc., a corporation, Bankrupt,

Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

RICHARD S. BERGER
LOUIS E. KEMPINSKY
GENDEL, RASKOFF, SHAPIRO & QUITTNER

1801 Century Park East
6th Floor
Los Angeles, California 90067
(213) 277-5400

Attorneys for Petitioner Lincoln Bank

PANDICK PRESS, WEST COAST, 1945 S. FIGUEROA, LOS ANGELES, CALIFORNIA (213) 747-4321

Lincoln Bank hereby petitions the Court for a writ of certiorari to issue to the United States Court of Appeals for the Ninth Circuit to review its Judgment in *Goggin v. Lincoln Bank,* No. 79-3360, entered on July 13, 1981.

QUESTIONS PRESENTED

1. May a district court refer a nonjury case to a special master pursuant to Rule 53(b) of the Federal Rules of Civil Procedure where a single plaintiff sought a readily ascertainable amount in damages from a single defendant, when neither party requested the reference, and where both the District Court and the Court of Appeals agreed that no exceptional circumstances existed to justify the reference?

2. May a district court cause a plenary action by a trustee in bankruptcy to be tried by the bankruptcy court over the objection of the defendant through the use of a Rule 53(b) reference?

3. Where a bank uses funds belonging to a third party to satisfy a debt owed to it by the bankrupt and thereafter is required to return a portion of those funds to the third party, may the trustee in bankruptcy of the bankrupt recover the funds initially used by the bank as a voidable preference? If so, may the bank offset from the trustee's recovery the portion of the funds it was required to return to the third party?

PARTIES TO THE PROCEEDING

The following entities have an interest in this proceeding in addition to the parties set forth in the caption:

David A. Commons, as substitute trustee in bankruptcy of Stabrite Pool Stores, Inc.

Manufacturers Bank, as successor in interest by merger to Lincoln Bank;

Mitsui-Manufacturers Bank, as successor in interest by merger to Manufacturers Bank.

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Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

OPINIONS BELOW

No opinion in this case has been published either officially or unofficially. The following opinions are included in the Appendix:

(a) Order of Referral to Special Master. [App. 1].

(b) Report and Recommendation and Decision of Special Master. [App. 4].

(c) Judgment of the United States District Court for the Central District of California adopting the decision of the special master. [App. 18].

(d) Memorandum of the United States Court of Appeals for the Ninth Circuit entered on May 26, 1981 affirming the judgment of the district court. [App. 20].

(e) Memorandum of the United States Court of Appeals for the Ninth Circuit entered on July 13, 1981 modifying Memorandum of May 26, 1981 and denying petition for rehearing. [App. 23].

(f) Order of the United States Court of Appeals for the Ninth Circuit entered on August 5, 1981 rejecting suggestion for rehearing en banc. [App. 28].

JURISDICTION

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1). The judgment of the United States Court of Appeals for the Ninth Circuit is contained in a Memorandum entered on May 26, 1981. [App. 20]. A Memorandum denying a petition for rehearing was entered on July 13, 1981. [App. 23]. An Order of the United States Court of Appeals for the Ninth Circuit rejecting a suggestion for rehearing en banc was entered on August 5, 1981. [App. 28].

STATUTES AND RULES INVOLVED

Pertinent portions of the following statutes and rules are set forth in the Appendix [App. 29]:

(a) 11 U.S.C. § 96(a)

(b) 11 U.S.C. § 108a

(c) Rule 53(b), Fed.R.Civ.P.

STATEMENT OF THE CASE

Stabrite Pool Stores, Inc. ("Stabrite") was a customer of Lincoln Bank. Stabrite owed Lincoln Bank $107,000 on a promissory note. Stabrite maintained its general checking account and a payroll checking account with Lincoln Bank. On June 18, 1971 Stabrite ceased doing business.

Prior to June 18, 1981, Stabrite had drawn $21,604.75 worth of checks on its general account and $427.09 worth of checks on its payroll account. Those checks were deposited by the payees, passed through the Los Angeles check clearing system, through the United California Bank computer system utilized by Lincoln Bank and through the internal bookkeeping department at Lincoln Bank, and were posted to Stabrite's accounts at Lincoln Bank, resulting in a total debit of $22,031.84.[1] This left $2,847.42 in the general account and $3,265.19 in the payroll account.

On June 18, 1971, at least 48 hours after it had received and processed these checks, Lincoln Bank dishonored them. It then recredited the two accounts with their face amount. On June 23, 1971, Lincoln Bank offset the sum of $28,144.45 (the amount recredited plus the remaining balance in the accounts) against Stabrite's commercial loan obligation.

Stabrite filed a voluntary petition in bankruptcy on June 24, 1971. Thereafter, the payees of $12,143.69 worth of the dishonored checks notified Lincoln Bank that its dishonoring of their checks was improper and demanded payment. Lincoln Bank paid these checks and debited the amount to the Stabrite checking accounts, leaving debit balances in these accounts. Ultimately, the debit balances were charged off and added to Stabrite's commercial loan obligation. Lincoln Bank did not file a claim in the Stabrite bankruptcy proceeding.

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[1] The approximately 40 checks totalling $21,604.75 were all posted to the Stabrite general account at least 24 hours before June 17, 1971. The 8 checks totalling $427.09 were posted to the Starbrite payroll account on June 21, 1971.

The Trustee in Bankruptcy for Stabrite commenced a plenary action against Lincoln Bank in the United States District Court for the Central District of California on August 2, 1972. Neither party demanded trial by jury. Although the Complaint contained nine separate counts, in substance the Trustee asserted only two claims: First, he sought to hold Lincoln Bank liable for all of Stabrite's debts as an alter ego of Stabrite; and second, he sought to recover the amount set off by Lincoln Bank as either a voidable preference or a fraudulent conveyance.[2]

On April 1, 1974, a pretrial conference was held before the District Court. During this conference the Court indicated its intention to refer the action to a special master and directed counsel for the Trustee to prepare an appropriate Order of Referral. Neither party had requested a special master. The Order of Referral was lodged with the District Court in November of 1974. Lincoln Bank promptly filed written objections. The Court overruled these objections, and the Order of Referral was entered on November 15, 1974 [App. 1].[3]

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[2] Although the Complaint prayed for damages "according to proof," their computation was easy in the event the Trustee prevailed on any of his theories. Damages based on the alter ego theory equalled the total of all claims filed by creditors in the Stabrite bankruptcy proceeding; damages for a voidable preference or fraudulent conveyance equalled the amount set off by Lincoln Bank against the checking accounts. All of these figures were established with specificity through discovery.

[3] The Order of Referral directed the Special Master to submit a transcript of all proceedings heard by him to the District Court with his Report and Recommendations. The Special Master did not have a court reporter on salary nor did he have any means of paying a court reporter. Therefore, on April 4, 1975 the Special Master filed his Report and Recommendation of Special Master re Modification of Order of Referral to Special Master in which he suggested (1) the daily cost of a reporter's appearance be paid in advance each day, (2) the costs of transcripts be paid in advance in accordance with the reporter's estimate, (3) the parties share equally in the costs, (4) the prevailing party recover his share of costs as an allowable item under Rule 54, Fed.R.Civ.P. Without giving the parties an opportunity to be heard, on April 4, 1975 the District Court signed and entered the Order appended to the Special Master's Report adopting in full the Master's suggestions.

Lincoln Bank continually asserted and preserved its objection to the reference while being compelled to proceed before the special master. Lincoln Bank sought a partial summary judgment on the Trustee's alter ego claims on the ground that the Trustee lacked standing to assert those claims. After extensive briefing and oral argument, the special master issued a Report and Recommendation granting Lincoln Bank's motion and the District Court entered an Order adopting and ratifying the Report. The Trustee appealed from the subsequent entry of judgment in favor of Lincoln Bank. The United States Court of Appeals for the Ninth Circuit filed a memorandum decision (Case No. 77-1764) affirming the judgment in its entirety on January 14, 1980.

On June 6, 7, 8, 13, 14, 15, 1977, July 19, 1977 and April 19, 1978, the special master conducted hearings on the Trustee's preference and fraudulent conveyance claims. On January 23, 1979, the special master filed his Report and Recommendation and Decision. [App. 4]. The special master found no evidence to support the fraudulent conveyance claim, and he upheld the offset exercised by Lincoln Bank under Section 68 of the Bankruptcy Act of 1898, 11 U.S.C. § 108, with respect to the balances left in the checking accounts after posting of the checks. On the other hand, the special master found that Lincoln Bank had received preferential payments equal to the amount of checks paid and then dishonored by Lincoln Bank. The master finally determined that although Lincoln Bank repaid $12,143.69 (more than 55%) of the dishonored checks, the bank could not deduct that amount from the preference, thus imposing a double liability on Lincoln Bank and resulting in a windfall to the trustee.

Lincoln Bank filed objections to the special master's decision with the District Court. The District Court mechanically approved and adopted both the findings of fact and conclusions of law drafted by the special master and overruled all of the Bank's objections. [App. 18]. The United States Court of Appeals for the Ninth Circuit affirmed. [App. 20].

In its Memorandum filed on May 26, 1981, the Ninth Circuit noted that "the referring of . . . [this] case by the trial court to a special master . . . is controlled by Rule 53(b) of the Federal Rules of Civil Procedure," and then summarily disposed of Petitioner's contention that the District Court erroneously referred this case to a master as follows:

> "This Court has held: 'This was a matter for the district judge's determination in light of his perception of whether the jury would find the issue complicated.' *Crateo, Inc. v. Intermark, Inc.*, 536 F.2d 862 (9th Cir. 1976). Because the trial court could properly find this state of facts to be 'complicated' within the concept of *Crateo* . . . , we do not think it appropriate to second guess the judge's exercise of his discretion in this matter."[4]

Without citation of authority other than a brief quotation from a Henry Wadsworth Longfellow poem, the Circuit briefly concluded that if funds of a third party had been used to partially satisfy Stabrite's obligation to Lincoln Bank, the very use of those funds made them property of Stabrite. The finding of a preference thus was affirmed.

Lincoln Bank petitioned for rehearing. On July 13, 1981 the Ninth Circuit filed a new Memorandum. [App. 23]. This time, without any support from the record and without mention of this Court's decision in *LaBuy v. Howes Leather Co.*, 352 U.S. 249, 77 S.Ct. 309, 1 L.Ed.2d 290 (1956), the Circuit concluded that "the matter referred to the special master here was such as could be considered by the trial court in its discretion as one of 'account and difficult computation of damages' . . . .". The reference was affirmed as was the preference judgment and a rehearing was denied.

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[4] The Court of Appeals' error was apparent. The *Crateo* case questioned the propriety of a reference to a master *in a case to be tried to a jury.* Obviously, its holding and the question whether the issues of this case were complicated were not relevant.

REASONS FOR GRANTING THE WRIT

The decision of the Court of Appeals is in direct conflict with this Court's decision in *LaBuy v. Howes Leather Co.*, 352 U.S. 249, 77 S.Ct. 309, 1 L.Ed.2d 290 (1956), and ignores the specific language of Rule 53(b) of the Federal Rules of Civil Procedure insofar as it approves an order of reference in a nonjury case where there are no exceptional circumstances justifying the reference.

The decision of the Court of Appeals is in direct conflict with its decision in *In re Pacific Homes*, 611 F.2d 1253 (9th Cir. 1980), and improperly compelled Lincoln Bank to litigate a plenary action in the bankruptcy court contrary to the provisions of 11 U.S.C. § 46(b).

The decision of the Court of Appeals disregards the specific requirement of 11 U.S.C. § 96(a)(1) that a voidable preference must be a transfer of "property of the debtor" and not property of a third party.

The decision of the Court of Appeals is in direct conflict with the Court of Appeals' own decision in *Bel-Marin Drywall, Inc. v. Grover*, 470 F.2d 932 (9th Cir. 1972), insofar as it did not permit petitioner to reduce the amount of its "preference" by the amount it was required to refund to the payees of the dishonored checks.

ARGUMENT

A. The Court of Appeals Has Ignored The Federal Rules Of Civil Procedure And A Controlling Decision Of This Court By Permitting A Reference To A Special Master.

References to masters are governed by Rule 53(b) of the Federal Rules of Civil Procedure. The policy towards references is articulated in the first sentence of the Rule:

> "A reference to a master shall be the *exception* and not the rule." [Emphasis added.]

The Rule then sets forth standards governing references in both jury and nonjury cases. Where, as here, no jury is involved, the following guidelines are promulgated:

> "[I]n actions to be tried without a jury, save in matters of account and of difficult computation of damages, a reference shall be made only upon a showing that some exceptional condition requires it."

The District Court, purporting to act under Rule 53(b), referred this action to a special master "for all purposes," including pretrial motions and trial. The Ninth Circuit's countenance of this conduct contravenes the clear import of Rule 53(b) and conflicts with the decision of this Court in *LaBuy v. Howes Leather Company,* 352 U.S. 249, 77 S.Ct. 309, 1 L.Ed.2d 290 (1956).

1. *No Exceptional Circumstances Existed In This Case To Justify The Reference To A Special Master.*

On November 15, 1974, the District Court entered its Order of Referral to Special Master. After stating that "this case involves numerous complicated bankruptcy issues and other intricate issues of fact and law," the Order of Referral concluded that in order "to save time and expedite litigation . . . [and] because of the complicated nature of this case, the matter should be referred to a Special Master with expertise in the bankruptcy field . . . ." The Order of Referral thereupon appointed as special master the bankruptcy judge to whom the Stabrite Pool Stores, Inc. bankruptcy had been assigned and, in effect, charged the bankruptcy judge with the duty of trying this action.

The same justifications for a reference given in this case were offered in *LaBuy* and flatly rejected by this Court as insufficient to constitute exceptional conditions under Rule

53(b). Decided in 1956, *LaBuy* remains the definitive and controlling interpretation of the propriety of references in nonjury cases.

LaBuy involved two large and admittedly complex antitrust lawsuits under the Sherman Act and Robinson-Patman Act. In one action, eighty-seven independent retail shoe repair shops sued six manufacturers and retail mail order houses; in the companion action, six wholesalers of shoe repair supplies sued six defendants, including manufacturers and wholesalers of these supplies and a retail shoe shop chain operator.[5] The actions had been pending for almost five years when the Court referred them to a special master. The trial was expected to last six weeks. The complaint sought injunctive relief, treble damages, and an accounting with respect to the discriminatory prices allegedly charged. 352 U.S. at 251, 77 S.Ct. at 311. The only exceptional circumstance found by this Court was the fact the matter had been referred at all, and this Court affirmed the writ of mandamus issued by the Court of Appeals for the Seventh Circuit compelling Judge LaBuy to vacate his order of reference.

In rejecting congestion or delay as a basis for the reference, this Court held:

> "[C]ongestion in itself is not such an exceptional circumstance as to warrant a reference to a master. If such were the test, present congestion would make references the rule rather than the exception . . . . Nor does petitioner's claim of the great length of time these trials will require offer exceptional grounds." [352 U.S. at 259, 77 S.Ct. at 315].

This Court found complexity of the issues to be an equally unsatisfactory ground for reference:

> "[I]n addition to calendar congestion . . . [petitioner] alleges that the cases referred had unusual complexity of issues of both fact and law. But most litigation in the

[5] These figures refer to the number of parties involved at the time of the reference. There were originally 35 additional parties which had been dimissed from cases by this time.

> antitrust field is complex. It does not follow that antitrust litigants are not entitled to a trial before a court. On the contrary, we believe that this is an impelling reason for a trial before a regular, experienced trial judge rather than before a temporary substitute appointed on an *ad hoc* basis and ordinarily not experienced in judicial work." [352 U.S. at 259, 77 S.Ct. at 315].

This position is compelled by the language in the Rule. Complexity is an acceptable basis for reference only in jury cases. Nonjury cases require the existence of exceptional circumstances. The nonjury test is without question far more restrictive. *Burgess v. Williams,* 302 F.2d 91, 94 fn. 4 (4th Cir. 1962); Kaufman, *Masters in the Federal Courts: Rule 53,* 58 Col. L.Rev. 452, 459 (1958).

This Court insisted on a rigid application of the exceptional condition test in *LaBuy:*

> "The use of masters is 'to aid judges in the performance of specific judicial duties, as they may arise in the progress of a cause,' *Ex parte Peterson,* 1920, 253 U.S. 300, 312, 40 S.Ct. 543, 547, 64 L.Ed. 919, and not to displace the court.
>
> * * *
>
> "[T]he practice of making references 'does not commend itself' and '* * * should seldom be made, and if at all only when unusual circumstances exist.' *In re Irving-Austin Building Corp.,* 7 Cir., 1938, 100 F.2d 574, 577 .... [T]he words 'exception' and 'exceptional' as used in the reference rule are not elastic terms with the trial court the sole judge of their elasticity. 'Litigants are entitled to a trial by the court, in every suit, save where exceptional circumstances are shown.' *Adventures in Good Eating, Inc. v. Best Places to Eat, Inc.,* 7 Cir. 131 F.2d 809, 185." [352 U.S. at 256, 258; 77 S.Ct. at 313, 314]

In discussing the exceptional condition test of Rule 53(b), it is stated in 9 Wright & Miller, *Federal Practice and Procedure,* Civil § 2605, pp. 789-791 (1971):

> "Even before the *LaBuy* case courts frequently held that there was no exceptional condition justifying a reference, and they have done so much more consistently since that decision. A reference is still proper on matters of account and of damages. The use of a special master to supervise discovery may still be appropriate and useful in unusual cases.
>
> "Beyond the situations just described it is difficult to conceive of a reference of a nonjury case that will meet the rigid standards of the *LaBuy* decision. This restrictive policy is necessary because reference of a nonjury case not only involves expense and delay but, since the master's findings must be accepted unless they are clearly erroneous, it also involves the danger that the master, not the court, will in fact decide the case." [Footnotes omitted.]

In a similar vein, in Kaufman, *Masters in the Federal Courts: Rule 53,* 58 Col. L.Rev. 452, 459 (1958), Judge Kaufman observed that:

> "[T]he utilization of special masters to hear and report on the main issues in litigation under Rule 53 has little support in the non-jury area. With a few minor exceptions, references in non-jury cases run counter to the spirit and purpose of judicial administration in the federal courts."

In this case, the Order of Referral made no findings whatsoever with respect to the existence of exceptional circumstances and, of course, could not do so since there would not have been evidence in support of such findings. The Order of Referral, therefore, was improper. See, e.g., *Bartlett-Collins Co. v. Surinam Navigation Co.,* 381 F.2d 546, 550-551 (10th Cir. 1967); *Arthur Murrary, Inc. v. Oliver,* 364 F.2d 28, 35 (8th Cir. 1966); *Brosious v. Pepsi-Cola Co.,* 3 F.R.D. 335, 335 (M.D. Pa. 1943).

2. *No Accounting Or Difficult Computation Of Damages Was Involved In This Case. Even If They Were, Their Existence Did Not Justify A Reference To A Special Master.*

The Court of Appeals apparently conceded the absence of any exceptional circumstances in its decision affirming the reference. Instead, it rationalized the result on a ground neither considered nor articulated by the District Court. It chose to rely on the two exceptions to the exceptional circumstance test, writing on page 3 of its July 13, 1981 Memorandum:

> "This, of course, is a 'matter of account' in that it involves a nine count complaint by the trustee in bankruptcy involving a large number of transactions between the bankrupt and the Bank. It is also a matter 'of difficult computation of damages' because of the very unusual circumstance made apparent on the record before the trial court. These are that *Lincoln Bank was relying on its own conversion of funds which it concedes belonged to other creditors of the bankrupt* in order to set up funds in the account of the bankrupt which it could then offset by its claim on a promissory note." [Emphasis in original.]

The facts of this case do not support the Court of Appeals' conclusion. Contrary to the Court's reasoning, the number of counts in the complaint does not presage the necessity for an account. Nor does the possible existence of tortious conduct make damages difficult to compute. In the case at bar the trustee sought to recover an amount equal to either the total amount of claims asserted in the Stabrite bankruptcy or the amount of the dishonored checks, depending on the particular claim. *Both figures were known long before trial.* They could not have presented any difficulty for the District Court.[6]

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[6] The Court of Appeal's position is even more absurd given the hindsight available to it. It must be remembered that neither problem (accounting or computation of damages) would exist if Lincoln Bank prevailed on all counts. As it turned out, plaintiff prevailed on only one count and the damages were easy to compute.

Furthermore, not every case which may involve an accounting qualifies for a reference under Rule 53(b). The "exception not the rule" policy set forth in the first sentence of the Rule still controls. Exceptional circumstances must exist to justify a reference even where it is based on an accounting or the computation of damages. Otherwise the exceptions would swallow up the rule.

In *Barrick v. Pratt,* 32 F.2d 732 (5th Cir. 1929), the Fifth Circuit confronted Equity Rule 59, the predecessor of Rule 53(b).[7] The Fifth Circuit first discussed the nature of the account sought in *Barrick:*

> "But the account involved in this case does not appear to have been either complex or intricate, but on the contrary to have been simple and easily understood . . . ."

The Court then vacated the order of reference, holding at 734:

> "We do not understand Rule 59 to mean that a trial judge ought not to hear the evidence of matters of account where the account is not involved or complicated."

See also, Helfer v. Corona Products, Inc., 127 F.2d 612 (8th Cir. 1942); *Howes Leather Company v. LaBuy* 226 F.2d 703 (8th Cir. 1955), *aff'd sub nom. LaBuy v. Howes Leather Company,* 352 U.S. 249, 77 S.Ct. 309, 1 L.Ed.2d 290 (1956). Compare, *Bennerson v. Joseph,* 583 F.2d 633 (3rd Cir. 1978) with *Magnaleasing, Inc. v. Staten Island Mall,* 428 F.Supp. 1039, *aff'd* 563 F.2d 567 (2nd Cir. 1977).

The commentators are all in accord with this view. For example, Professor Moore states:

> "Implicit in this is that in matters of account a reference can be justified when the matter is complex. The mere fact, however, that an accounting may be necessary is not enough to justify a reference; it must appear that the

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[7] Equity Rule 59 provided, in pertinent part: "Save in matter of account, a reference to a master shall be the exception, not the rule, and shall be made only upon a showing that some exceptional condition requires it."

matter is complex and would take an undue amount of the court's time." [5A Moore, Federal Practice, ¶ 53.05(2), p. 2939 (2nd ed. 1980)].

The import of these statements is that the need for an accounting does not warrant a wholesale reference to a special master. This was made explicitly clear by this Court in *LaBuy:*

> "The final ground asserted by petitioner was with reference to the voluminous accounting which would be necessary in the event the plaintiffs prevailed. We agree that the detailed accounting required in order to determine the damages suffered by each plaintiff might be referred to a master *after* the court has determined the overall liability of defendants, provided the circumstances indicate that the use of the court's time is not warranted in receiving the proof and making the tabulation." [Emphasis added; 352 U.S. at 259, 77 S.Ct. at 315.]

The purpose for carving out an exception when matters of account or difficult computation of damages are involved supports at best the practice of a limited reference after a court has determined liability. As Judge Kaufman observed:

> "[A]n accounting involves a mechanical application of general investigatory and accounting principles and is often required under circumstances where much exploratory work into books and records is essential. To impose this duty on the court will result in a severe drain on limited judicial man-hours which could be more profitably exploited in other avenues of judicial endeavor. No peculiar judicial talent or insight is required, and errors in accounting lend themselves to detection and correction on review by the court. . . . *The question of liability, for instance is one that the court is better endowed to determine, and only after this issue has been resolved by the court should an accounting, if such be found necessary, be referred to a special master."* [Kaufman, *Masters in the Federal Courts: Rule 53, supra* at 457.]

Petitioner respectfully submits that the Court of Appeals has forgotten the rule of *LaBuy*. This Court should grant certiorari to cure that error.

3. *The Reference Being Improper, Petitioner Is Entitled To A Trial By The District Court.*

The facts of this case did not justify a reference of this matter either in whole or in part. Petitioner was thus entitled to a trial before a district court, and the Court of Appeals erred in failing to reverse the District Court's action. An improper reference cannot be rationalized away by the Court of Appeals. It is inherently prejudicial. This results in large part from the mandate in Rule 53(e) that the master's findings of fact *must* be accepted unless clearly erroneous. As Judge Kaufman observed:

> "References under the rule are not advisory in the sense that a court is free to reject a Master's report at will and to conduct its own independent inquiry into the facts. Thus under the rule, the fact that a court would be disposed to attach different weight to some of the facts presented in an issue submitted for reference is insufficient to justify a rejection of a Master's report. *Consequently, a litigant might be prejudiced, notwithstanding the necessity of confirmation by the courts. He is entitled to have the court hear and determine the issues in the first instance, and anything short of this may be an abridgment of his rights.*" [Emphasis added.]

B. Petitioner Was Compelled To Litigate Its Case In A Prejudicial Forum.

Section 23b of the Bankruptcy Act of 1898, 11 U.S.C. § 46(b), provides that unless a defendant consents to a plenary action being tried before a bankruptcy judge, the action must be tried in a court having jurisdiction over the parties—in this case the United States District Court for the Central District of

California. The trustee commenced his action in the proper court. The district court, however, refused to accept the case and referred it to the bankruptcy judge handling the Stabrite bankruptcy. The Court of Appeals approved that procedure.

A nearly identical situation existed in *In re Pacific Homes*, 611 F.2d 1253 (9th Cir. 1980). There, a Chapter X trustee filed a plenary action in the district court. The district court referred the action to the bankruptcy judge before whom the Chapter X proceedings were pending. When the district court refused to vacate its order of reference, an interlocutory appeal was perfected to the Court of Appeals. The Court of Appeals reversed, stating at page 1255 of its opinion:

> "It is beyond dispute that under the Bankruptcy Act of 1938, the bankruptcy judge may not hear a plenary action in a straight bankruptcy proceeding without the consent of the defendants."

In the case now before this Court, a bankruptcy trustee filed a plenary action in the district court.[8] The district court referred the action to the bankruptcy judge before whom the bankruptcy proceedings were pending. All objections to proceeding before the bankruptcy judge were preserved and upon final judgment an appeal was perfected to the Court of Appeals. Despite the fact that *In re Pacific Homes* was called to the attention of the Court and was thoroughly discussed during oral argument, the Court of Appeals' Memoranda filed on May 26 and July 13, 1981 do not mention *In re Pacific Homes*. As a result, by affirming the reference to the bankruptcy judge, the Court of Appeals has taken inconsistent positions when faced with identical situations. The effect of that inconsistency is underscored by the following statement from *In re Pacific Homes:*

> "A further important policy consideration supports our conclusion. Before the Bankruptcy Reform Act of 1978, the bankruptcy judge was intimately involved with the

[8] The same district judge was involved in this case and in *In re Pacific Homes*.

> administrative steps in reorganization of the bankruptcy estate . . . . The nature of the bankruptcy judge's administrative duties under that statute encouraged ex parte contact with the trustee and created the opportunity for gaining independent factual knowledge of the suit. Furthermore, the bankruptcy judges frequently appointed the trustees who appeared as litigants before them. These factors might have created the appearance of prejudice in favor of the estate, if not actual prejudice. . . . We hold that, under the previous law, plenary actions brought by the trustee in a reorganization proceeding must be heard by a district judge unless the defendants consent to the jurisdiction of the bankruptcy judge." [611 F.2d at 1257; citations omitted.]

Here, too, the District Court compelled Lincoln Bank to litigate a plenary action before the bankruptcy court over its objections. The prejudice to Lincoln Bank exists irrespective of the basis for the reference.

In commenting on the effect of an unwarranted reference, this court held in *LaBuy:*

> "Under all of the circumstances, we believe the Court of Appeals was justified in finding the orders of reference were an abuse of the petitioner's power under Rule 53(b). They amounted to little less than an abdication of the judicial function depriving the parties of a trial before the court on the basic issues involved in the litigation." [352 U.S. at 256, 77 S. Ct. at 313.]

The District Court abdicated its judicial function and deprived Lincoln Bank of a trial before the court on the basic issues of the litigation. As a result, the decision of the Ninth Circuit must be vacated and this action remanded to the District Court for trial.

C. The Court of Appeals Disregarded Explicit Provisions of the Bankruptcy Act of 1898.

A voidable preference must involve a transfer of the *debtor's property.* This is the first and fundamental element of a preference. *I-T-E Circuit Breaker Co. v. Holzman,* 34 F.2d 102, 106 (9th Cir. 1965); 11 U.S.C. § 96 (a)(1).

The Court will recall that after Stabrite ceased doing business, b before it commenced its bankruptcy proceeding, Lincoln Bank reversed the posting of $22,031.84 of Stabrite checks, *each of which had been posted to the Stabrite accounts for more than 24 hours,*[9] thereby refusing to honor those checks, recredited Stabrite's commercial accounts in the sum of $22,031.84 and offset that sum (plus the sums already on deposit in the accounts) against Stabrite's loan obligation to the Bank. Lincoln Bank respectfully submits that, both logically and as a matter of law, the funds recredited to the Stabrite account and used by Lincoln Bank as an offset were not the property of Stabrite.

The Bankruptcy Act of 1898 does not define the phrase "property of the debtor." Reference therefore must be made to state law to determine the meaning of that term.

In *McKeon v. Bisbie,* 9 Cal. 137, 142 (1858), the California Supreme Court opined:

> "Property is the exclusive right of possessing, enjoying, and disposing of a thing; it is 'the right and interest which a man has in lands and chattels, to the exclusion of others;' and the term is sufficiently comprehensive to include every species of estate, real or personal."

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[9] The fact that the checks had been posted for more than 24 hours was admitted by the Trustee. That fact forms the basis of Lincoln Bank's position that the fund created by the reversing entry was not Stabrite's property.

Similarly, in *Cohen v. Wright,* 22 Cal. 293, 320 (1863), the California Supreme Court stated:

> "Property is the right of any person to possess, use, enjoy, and dispose of a thing. The term, although frequently applied to the thing itself, in strictness means only the rights of the owner in relation to it."

Finally, in *Spring Valley Water Works v. Schottler,* 62 Cal. 69, 84 (1882), the California Supreme Court held:

> "Webster defines property to be: '4. The exclusive right of possessing, enjoying, and disposing of a thing; ownership; 6. An estate, whether in lands, goods, or money.' Blackstone, Book 1, page 138, speaks of property as an absolute right 'which consists in the free use, enjoyment, and disposal of all his acquisitions without any control or diminution, save only by the laws of the land,' and in another place, Book 2, page 2, speaks of the right of property as 'that sole and despotic dominion which one man claims and exercises over the external things of the world in total exclusion of the right of any other individual in the universe.' Bouvier, in his Law Dictionary, in defining the word property, says: 'It is the right to enjoy and to dispose of certain things in the most absolute manner, * * * so that property, considered as an exclusive right to things, contains not only a right to use those things, but a right to dispose of them, either by exchanging them for other things, or by giving them away to any other person, without any consideration, or even throwing them away.' "

Lincoln Bank submits that when it dishonored the Stabrite checks and recredited the face amount thereof to the Stabrite accounts, Stabrite no longer had the free right, or any right at all, to use, enjoy or dispose of those funds. In other words, those funds were not the property of Stabrite.

It is basic law that a depositor-bank relationship is a creditor-debtor relationship. When the bank account is a commercial checking account, the depositor directs the bank how, to whom and in what amount to pay out the funds deposited in the account. Those directions are given by checks drawn on the account and presented in the normal course of business to the bank. Clearly, up to this point of time, the bank deposit is "property" of the depositor in that the depositor has the sole and exclusive right to dictate the disposition of the deposit. After his checks are presented to the bank, however, that right is strictly circumscribed and abruptly comes to an end.

Section 4403(1) of the California Commercial Code provides:

> "Any customer . . . may stop payment of any item . . . drawn against such customer's . . . account but the bank may disregard the same unless the order . . . is received by the bank in such time and in such manner as to afford the bank a reasonable opportunity to act on it prior to the happening of any of the events described in Section 4303."

Section 4303(1) lists six events, the occurrence of any of which precludes a depositor from stopping payment on a check. Only two of these events, specified in Section 4303(1)(d) and (e), are relevant to this case:

> "(d) The cutoff hour (Section 4107) or the close of the banking day if no cutoff hour is fixed on the day on which the bank received the item; (e) The bank has become accountable for the amount of the item under subdivision (1)(d) of Section 4213 and Section 4302 dealing with the payor bank's responsibility for late return of items . . . ."

Unquestionably, all of the checks which combined together total the $22,031.84 reversing entry were held by Lincoln Bank long past the bank's cutoff hour as set forth in Section 4107 of the Commercial Code, long past the close of Lincoln Bank's

banking day if Lincoln Bank had no cutoff hour and, admittedly, Lincoln Bank had become accountable to the payees of the checks because of its late return of each of the checks.

The import of Section 4403(1) of the Commercial Code, restricting and limiting a depositor's right to stop payment on checks that he has drawn against his account, similarly restricts and limits the depositor's claim that the funds on deposit constitute his "property." Clearly, if a depositor no longer has the right to direct to whom and in what amount funds are to be paid, he no longer has dominion or control over those funds and, therefore, those funds (or the bank credit that represents those funds) are no longer the "property" of the depositor.

That the depositor's ownership of the funds on deposit ends before the drawee bank acts upon checks drawn against those funds is made clear in Hawkland, *Stop Payment Orders Under the Uniform Commercial Code*, 3 U.C.C.L.J. 103, 112-113 (1970), where Professor Hawkland states:

> "Under Section 4-302 the payor becomes liable for an item if it does not give the presenting bank a provisional credit by midnight of the banking day it receives it, or if it does not give notice of dishonor by its midnight deadline. For example, if a check reaches the payor bank on Monday, it will be deemed to have made final payment of it at midnight Monday if it has not by then given the presenting bank a provisional credit, or at midnight Tuesday (the midnight deadline) even if a provisional credit has been given in a timely manner but no notice of dishonor has been given by midnight Tuesday. These rules constitute the law of "late returns" and provide an outside limit of time during which a check may be stopped. In the normal course of events the power to stop payment will have terminated before the late-return point through posting, settlement or the like, but in no case can it extend beyond this point.

> It should be remembered, of course, that the rules of final payment set out in Section 4-303 and discussed above are terminal points for the stop order but that the drawer's power to stop usually ends at an earlier time due to the additional requirement found in Section 4-403 that the notice be received "at such time and in such manner as to afford the bank a reasonable opportunity to act on it prior to any action by the bank with respect to the item described in Section 4-303."

Since Stabrite could not have stopped the payment of the checks that formed the basis of Lincoln Bank's reversing entry, it clearly had lost all of its property interest in those checks and the funds against which those checks were drawn.

Stabrite's lack of a property interest in the funds that were the subject of the reversing entry is further emphasized by Section 4302(a) of the California Commercial Code:

> "[I]f an item is presented on and received by a payor bank *the bank is accountable for the amount of*
>
> > (a) *A demand item* other than a documentary draft whether properly payable or not *if the bank . . . does not pay or return the item or send notice of dishonor until after its midnight deadline.*" [Emphasis added.]

Admittedly, Lincoln Bank held the $22,031.84 of Stabrite checks long past its midnight deadline before dishonoring the checks and recrediting the Stabrite account in the face amount thereof. As a result, under Section 4302(a) Lincoln Bank became accountable to the payees of those checks; that is, a duty was imposed upon Lincoln Bank to account for and pay over to the payees of the checks the face amount of the checks. *See* California Commercial Code § 4213(1) and Uniform Commercial Code Comment 7 thereto. When Lincoln Bank held the checks past its midnight deadline, whether or not it actually paid the checks became irrelevant. There was payment as a matter of law.

Of course, upon payment of a check the drawer thereof effectively transfers the funds used to pay the check and no longer has an interest therein. See 3 (Part 2) Collier on Bankruptcy, ¶60.14, pp. 821-823 (14th ed. 1977). Clearly, therefore, Stabrite lost any property interest it may have had in the $22,031.84 long before the date of the reversing entry. When Lincoln Bank used those funds to offset against Stabrite's loan obligation, the funds were not property of Stabrite and there was no preferential transfer.

The situation here is much like that where a third person uses his own funds to pay a creditor. Lincoln Bank was, at the time of the offset, "accountable" to the payees of the checks in the sum of $22,031.84 — in other words, the $22,031.84 belonged to the payees. Their money, and not funds of Stabrite, was used to pay Lincoln Bank. This is not a preference. *See* 3 (Part 2) Collier on Bankruptcy, ¶60.26, p. 880 (14th ed. 1977):

> "A transfer of money or property by a third person to a creditor of a bankrupt, which transfer does not issue from the assets of the bankrupt, does not diminish the bankrupt's estate and is therefore not a preference."

See also 4 Remington on Bankruptcy § 1670, pp. 236-237 (1957):

> "In view of the fact that the voidable preference provisions of § 60 are directed only to protecting the estate of the bankrupt against depletion in favor of selected creditors and do not apply unless property or funds of the bankrupt are involved, no preference voidable thereunder can result from payments made out of the funds or property of third persons, even though the payments are turned over to the creditor by the bankrupt."

This case is analogous to *Saper v. Wood*, 249 F.2d 401 (9th Cir. 1957). There, the bankrupt had assigned all of its right, title and interest in a fund on deposit with the state court to a third person. The creditor attached and executed on this fund,

and then used the fund to reduce its claim against the bankrupt. As in the case at bar, the trustee did not attack the assignment by the bankrupt to the third person. The trustee instead attempted to set aside the transfer from the third party to the creditor. The Court of Appeals found no voidable preference, stating at page 404:

> "[T]he trustee did not prove affirmatively that the money belonged to . . . [the bankrupt] at the critical period or that it was ever entitled to the possession thereof."

Here, too, the bankrupt effectively assigned away all of its right, title and interest to the funds covered by the checks when these checks were deposited and paid. The bankrupt never acquired any new property rights in these funds. Funds used by Lincoln Bank as an offset were thus not property of Stabrite at the time of the offset. No preference resulted from the offset. Clearly, the Court of Appeals did not understand the foregoing. As a result its judgment is in direct conflict with the provisions of Section 60 of the Bankruptcy Act of 1898, 11 U.S.C. § 96.

D. If Lincoln Bank Did Receive A Voidable Preference, It Is Entitled To Offset The $12,143.69 It Was Obligated And Did In Fact Refund To Holders Of Late Dishonored Stabrite Checks.

The trustee admitted and the Special Master found that when Lincoln Bank dishonored the $22,031.84 worth of checks and posted that sum to the Stabrite account, Lincoln Bank had already become "accountable" for those checks to the payees thereof. *See* California Commercial Code §§ 4213 (1) and 4302(a). The payees of $12,143.69 worth of the dishonored checks demanded payment and Lincoln Bank ultimately paid these previously dishonored checks. This reduced the amount of its reversing entry and offset from $22,031.84 to $9,888.15.

Lincoln Bank's right to a credit for its postpetition payment of the $12,143.69 worth of late dishonored checks is grounded not on Section 60c of the Bankruptcy Act, 11 U.S.C. § 96c, but rather on Section 68 of the Act, 11 U.S.C. § 108. By its very terms, Section 68 applies to offsetting claims (credits) arising both before and after the filing of a petition.

The decision in ***Bel Marin Driwall, Inc. v. Grover,*** 470 F.2d 932 (9th Cir. 1972) is squarely on point. It held that a creditor could offset a payment made pursuant to an independent obligation even after the filing of the petition. In ***Bel Marin,*** Summers, a general contractor, employed Driwall as a subcontractor. Summers owed Driwall a sum of money in excess of $1,500.00. G-D was a paint company which had supplied materials to Driwall for which Driwall had failed to pay. Under the controlling law, G-D could recover the cost of the materials from Summers. On September 22, 1969, G-D notified Summers and his surety of its claim for materials furnished. This claim amounted to approximately $1,400.00.

On October 17, 1969, Driwall filed a voluntary petition in bankruptcy and a trustee was appointed. On January 20, 1970, while the insolvency proceedings were pending, Summers paid G-D for the paint. The trustee then sought a turnover order for the money Summers admittedly owed the bankrupt, and Summers tried to offset against that debt the money he had paid to G-D, the creditor of the bankrupt.

The bankruptcy court rejected this argument and the district court affirmed. The Ninth Circuit reversed, holding that Summers could exercise an offset. After examining applicable California law, the Court found that Summers had an independent, statutorily-imposed, incontrovertible, and fully-matured duty to pay G-D. This entitled Summers to offset the payment against its obligation to Driwall:

> "Summers therefore legally owed and properly paid a direct obligation to G-D, which was independent of the bankrupt's obligation to G-D. By its payment, Summers

> did acquire a setoff, but not 'with a view to [use as a setoff]' under §68b(2) of the Act. . . ." [Footnote omitted; bracketed material in original.]

The trustee argued that the post-petition payment by Summers to G-D was improper in any event because it was made from funds held by Summers for the account of the bankrupt, and title to those funds passed to the trustee on the date of bankruptcy. This Court rejected this, reasoning that while the trustee arguably had some sort of interest in the funds, he took the property subject to the equities of creditors (such as G-D) who had a superior right to the money by operation of state law.

The parallels between *Bel Marin* and the instant case are striking. Here, Lincoln Bank occupies the same position as Summers, and Stabrite's trade creditors occupy G-D's position. Stabrite maintained a checking account with Lincoln Bank, and Lincoln Bank "owed" Stabrite the balance of the checking account. Stabrite wrote checks on that account and the creditors presented their checks to Lincoln Bank. By operation of Section 4302 of the California Commercial Code, the claims of the creditors matured as against Lincoln Bank, and Lincoln Bank therefore had an incontrovertible, statutorily-imposed, fully-matured, and independent duty to pay those checks, just as Summer's was duty-bound to pay G-D. Lincoln Bank performed after the filing of the petition, just as Summers did.

A further parallel to *Bel Marin* and, indeed, a factor which makes the instant case stronger than *Bel Marin,* is the effect of California Commercial Code Section 4303 on the bankrupt's entitlement to the funds. In *Bel Marin,* the notification by G-D cut off or superseded the bankrupt's interest in the funds. Here, not only does Section 4302 create a superior right to the funds in the creditors, but Section 4303 explicitly terminated Stabrite's right to affect the disposition of the checks. Thus, the trustee faced a double barrier in this case whereas *Bel Marin* involved only one.

CONCLUSION

For each of the foregoing reasons, Lincoln Bank respectfully submits that its petition should be granted.

Respectfully submitted,

By _____
RICHARD S. BERGER
Attorney for Petitioner
Lincoln Bank

LOUIS E. KEMPINSKY
GENDEL, RASKOFF, SHAPIRO & QUITTNER
Of Counsel

Elihu M. Berle, an Associate of the
Law Offices of BUCHALTER
NEMER, FIELDS, & SAVITCH
(A Professional Corporation)
727 West Seventh Street
Los Angeles, California 90017
Telephone 627-9751

Attorneys for Plaintiff

RECEIVED
November 7, 1979
Clerk, U.S. District Court
Central District of California
By Deputy

FILED
November 15, 1974
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By Deputy

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

TERRANCE P. GOGGIN, as Trustee for STABRITE POOL STORES, INC., a California corporation, Bankrupt,

Plaintiff,

vs.

LINCOLN BANK, a California corporation,

Defendant.

No. 72-1766-AAH

ORDER OF REFERRAL TO SPECIAL MASTER

WHEREAS, this case involves numerous complicated bankruptcy issues and other intricate issues of fact and law; and

WHEREAS, at the Pre-Trial Conference held on April 1, 1974, the Court decided that because of the complicated nature of this case, the matter should be referred to a Special Master with expertise in the bankruptcy field; and to save time and expedite litigation; and good cause existing therefor,

IT IS HEREBY ORDERED as follows:

1. The action entitled "Terrance P. Goggin, as Trustee of Stabrite Pool Stores, Inc., a California corporation, Bankrupt, Plaintiff, vs. Lincoln Bank, a California corporation, Defendant" (U.S.D.C., C.D. Cal. No. 72-1766-AAH) shall be referred for all purposes to Bankruptcy Judge Robert Ordin, who is the Bankruptcy Judge to which the Stabrite Pool Stores, Inc. bankruptcy (U.S.D.C. C.D. Cal. No. 93574) is assigned, as a Special Master.

2. The Special Master shall hear all testimony and take documentary and other evidence on all issues of fact set forth in the Pretrial Conference Order and all other factual issues necessary to resolve this case.

3. The Special Master shall preside over and hear all argument relating to all legal issues set forth in the Pretrial Conference Order and other legal issues necessary to resolve this case.

4. The Special Master shall determine all issues of fact and law.

5. At the conclusion of all hearings on issues of fact and law, the Special Master shall prepare a report on all controverted issues which shall set forth the Special Master's Findings of Fact and Conclusions of Law.

6. The Special Master shall file his report with the Clerk of the United States District Court for the Central District of California, together with a transcript of the proceedings and of the evidence and the original exhibits.

7. The Clerk shall mail notice to all parties of the filing of said Master's Report.

8. Within ten (10) days after being served with notice of the filing of the Report, any party may serve written objections to said Report upon the other parties.

9. Application to the Court for an action upon report and upon objection thereto shall be by motion and upon notice as prescribed in Rule 6(d) of the Federal Rules of Civil Procedure and Rule 3 of the Local Rules of the United States District Court for the Central District of California.

Dated: November 15, 1974.

/s/ A. Andrew Hauk

The Honorable A. Andrew Hauk
United States District Judge
United States District Court
for the Central District of
California

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

TERRANCE P. GOGGIN, as Trustee for STABRITE POOLS, INC., a California corporation, Bankrupt, *Plaintiff,* vs. LINCOLN BANK, a California corporation, *Defendant.*	**No. 72-1766-AAH** **REPORT AND RECOMMENDATION OF SPECIAL MASTER**

By Order filed November 15, 1974, the within proceeding was referred to the undersigned as Special Master by the Honorable A. Andrew Hauk, District Court Judge. The Order directed the Special Master to determine all issues of fact and law and to report thereon to the District Court.

Pursuant to said Order, the parties proceeded with discovery, motion and pretrial procedures and the cause was tried before the Special Master on June 6, June 7, June 8, June 13, June 14 and June 15, 1977. The matter was thereafter argued and briefed and was finally submitted to the Special Master for his determinations of fact and law on April 19, 1978. Thereafter, additional briefs were filed by the parties.

The undersigned, as Special Master, having read and considered the pleadings and briefs submitted by the parties, and having heard and considered the evidence received, and being fully advised in the premises, has made and rendered Findings of Fact and Conclusions of Law in the form of a written Decision determining the factual issues, the law applicable thereto, and a recommendation as to the Judgment that should be entered by the District Court in this cause.

Accordingly, there is hereby submitted to the Clerk of the District Court, pursuant to Rule 53(e)(i), the following:

1. This Report and Recommendation of the undersigned as Special Master; and

2. The Decision of the Special Master; and

3. The original exhibits adduced at the hearings held before the Special Master, as hereinabove set forth; and

4. A transcript of the trial proceedings and the evidence offered and received before the Special Master on June 6, 7, 8 and 13, 1977. I am advised by the court reporter that the proceedings on June 15, 1977 consisted entirely of oral argument and have not been transcribed.

Dated: January 23, 1979

/s/ Robert L. Ordin

ROBERT L. ORDIN, Special Master

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

TERRANCE P. GOGGIN, as Trustee for STABRITE POOLS, INC., a California corporation, Bankrupt, *Plaintiff,* vs. LINCOLN BANK, a California corporation, *Defendant.*	**No. 72-1766-AAH** **DECISION OF SPECIAL MASTER**

PRELIMINARY STATEMENT

1. This is an action by the Trustee in Bankruptcy of STABRITE POOLS, INC. to recover voidable preferences and fraudulent conveyances.

2. The Complaint attempted to frame nine separate counts.

3. By Order filed November 15, 1974, the District Court referred the action to the undersigned as Special Master, to determine all issues of fact and law and to report thereon to the District Court.

4. Thereafter, Counts 7, 8 and 9 were dismissed by Order of the District Court entered August 20, 1976, pursuant to the Report and Recommendations of the Special Master filed on or about June 1, 1976.

FINDINGS OF FACT

1. The relationship between STABRIGHT POOLS, INC. (hereinafter "STABRITE") and LINCOLN BANK (hereinafter "BANK") can be summarized by following the chronologh of events.

a. 8-24-70 loan by BANK to STABRITE of $16,000.00

b. 1-29-71 loan by BANK to STABRITE $69,000.00

c. 2-24-71 payment by STABRITE to BANK $1,000.00

d. 3-03-71 payment $1,000.00 STARBRITE to BANK

e. 3-22-71 payment STABRITE to BANK $2,000.00

f. 3-22-71 loan by BANK to STABRITE $107,000.00

g. 6-18-71 STABRITE ceased business operations (reversing entries made)

h. 6-24-71 Bankruptcy

2. The evidence further reflects the following:

a. Some time in March, 1971, a bank loan officer and assistant vice president (Waldman) was placed in the STABRITE business premises on a full-time basis by the BANK. He was instructed to observe the business operation and report to the BANK. His desk was in close proximity to that of the bookkeeper. His routine at STABRITE included the following:

i. He was given each day a list of monies received by STABRITE in its business operations, as well as a list of checks drawn by STABRITE on its accounts at LINCOLN BANK.

ii. He familiarized himself with the jobs undertaken by STABRITE and the purchase of materials necessary to perform the work.

iii. His activities were limited to this type of study of internal cost structure, the flow of cash and the processing and completion of the jobs undertaken and done by STABRITE.

iv. He was aware, at all times, of the status of STABRITE's debt to the BANK and of the daily fluctuations in the bank balances of STABRITE's accounts.

v. He became aware of the previous overdrawn condition which existed on STABRITE's general bank account, as reflected on Exhibit 1.

b. Because of the delicate financial condition of STABRITE and its traditional cash short position, the BANK had invoked a procedure known as "99 hold." This procedure involved the following:

i. The computer used to reflect receipts of checks by the BANK was leased from UCB. The computer was instructed that checks would not be posted to STABRITE's account until a decision was made as to whether the checks would be cleared.

ii. That decision was made by an officer at the BANK.

c. The BANK also adopted a practice of issuing daily bank statements to STABRITE. Exhibit 1 consists of these bank statements for the periods between January 5, 1971, and June 16, 1971 (some, not all).

d. On June 17, Waldman and English (branch manager of the BANK) had intensive discussions with third persons in an effort to prevent what then appeared to be a shutdown of the business. STABRITE's manager at that time was Batson. On June 17th Batson was aware that STABRITE's emloyees had not been paid for two weeks and that insufficient funds were on hand to pay them and to meet payroll for the following week. These facts were

also known to English and Waldman. The conversations with third persons, referred to above, consisted of phone calls to Franz in Chicago. English and Batson both participated in telephone conversations whereby Batson made known to Franz that the business would shut down unless Franz advanced money immediately. English confirmed this matter to Franz and sought to induce Franz to advance funds. Franz was told by English and Batson that unless an immediate advance of $10,000.00 was made the business would close forthwith. Franz refused.

e. On June 18 STABRITE ceased its business operations. English and Batson were present at STABRITE. The branch location managers of STABRITE brought into the main office the receipts from the previous day and delivered them to Batson. The employees were advised that the business was closing and departed. Batson, with the help of English, prepared a deposit slip reflecting the funds brought in from the branches. Batson left the monies and deposit slip with English and departed the STABRITE premises. English carried the funds to the bank and caused the physical and mechanical act of deposit of the receipts of June 17th to be made at or about noon on June 18th.

f. By June 17th the BANK had received checks issued by STABRITE in the aggregate amount of $21,604.75. These checks had passed through the UCB computer and the internal bookkeeping department and system at the BANK, had been verified as to form of the check and signature and a determination had been made that there were funds on hand in STABRITE's account sufficient to pay the checks. In addition, and some time prior to June 18, 1971, BANK personnel had made the decision to pay the checks and STABRITE's account had been posted so as to debit STABRITE's account and reflect deductions in the amount of these checks.

g. The BANK acknowledges its inability to supply any precise evidence or details with respect to the checks involved in this $21,604.75, the time and date when these checks, or any of them, were received by the BANK, the time and date upon which the decision was made to pay the checks, or the date upon which the checks were posted for payment. With respect to the $3,265.19 in the payroll account prior to the reversing entry, these funds were all deposited prior to the final deposit on June 18th. There is no evidence as to the circumstances surrounding the deposit in the payroll account of $3,265.19.

h. At some time between noon and 6 p.m. on the 18th the BANK elected to do the following:

i. Offset the BANK's claims against STABRITE against the funds on deposit in STABRITE's account. In order to accomplish the offset, it was necessary for the BANK to do, and it did, the following on June 18th:

A. A decision was made not to honor the $21,604.75 in checks, but to increase the funds in the STABRITE account by $21,606.75. This would make available in the STABRITE account for offset purposes an aggregate of $24,552.17, which consisting of the $21,604.75 plus other funds in the account on June 18th; and

B. A reversing entry was made in the general account whereby the $21,604.75 of checks posted for payment was reversed.

ii. *The Payroll Account* A similar transaction occurred with respect to the payroll account. The reversing entry, however, was made on June 22 in the sum of $427.09. At the time the reversing entry was made, however, there was a balance in the payroll account of $3,265.19, against which no checks had been presented. After the reversing entry of $427.09,

the payroll account reflected a balance of $3,692.28. With respect to the $3,265.19 in the payroll account prior to the reversing entry, these funds were all deposited prior to the final deposit on June 18th. There is no evidence as to the circumstances surrounding the deposit in the payroll account of the $3,265.19.

ANALYSIS

1. Based upon the foregoing, the Trustee seeks to recover:

a. The sum of $28,250.13, consisting of (i) $24,552.17, which includes the reversing entry of $21,604.75, together with all other funds in the general account on the 18th; (ii) $3,692.28, the amount in the payroll account after the reversing entry of $427.09; and (iii) $5.68 derived from a source not deemed relevant (by Stipulation).

2. Before discussing the primary issues in this case, certain peripheral matters should be disposed of:

a. The third, fourth and fifth causes of action, based upon 67(d)(2)(d), C.C.3409.07 and 67(d)(3) have not been established. The third and fourth causes of action assert fraudulent transfers with actual intent to hinder, delay and defraud creditors. No evidence supports these causes of action, and judgment thereon should be for the defendant.

b. The February 24th and March 3rd payments of $1,000.00 each are not within the issues preserved for trial in the Pretrial Order. The Complaint in this case asserted a preference in the most general language. The allegations asserted, in effect, that within four months prior to bankruptcy, STABRITE made transfers of approximately $125,000.00 to the BANK and these transfers were preferences. With respect thereto, the Complaint states:

"Plaintiff will amend this Complaint to state the true amount when the same is ascertained."

No such amendment was ever sought nor made. The original Pretrial Conference Order referred to the fact that prior to March 22nd STABRITE had paid $2,000.00 of its $69,000.00 debt to BANK. No reference is made to the February 24th or March 3rd payments as such. Subsequent to the referral of the matter to the Special Master, an Amended Joint Pretrial Order was filed. Therein it is set forth that prior to March 22, 1971, STABRITE had repaid $2,000.00 to the BANK on its $69,000.00 obligation. In an effort to refine and define the issues to be tried, counsel for the BANK submitted Interrogatories which requested specific information as to the amounts of the preferences and the dates and data with respect thereto. An answer was filed by counsel for the Trustee in which it was asserted that the preferences sought to be recovered consisted of the aggregate of $28,250.13. This sum was based upon the computations and details hereinabove set forth. At the time of trial it was stipulated to that the BANK received the February 24, 1971 and March 3, 1971 payments of $1,000.00 each. At the conclusion of the trial, plaintiff asked that the Complaint be deemed amended under FRCP 15(a) to include the two $1,000.00 payments and that the prayer be read to include a preference of $30,250.13. The BANK objected, on the grounds that the Trustee failed to place the two $1,000.00 payments in issue in its response to Interrogatories and that the BANK had no reason to anticipate the amendment to the prayer now sought to be accomplished. Under the foregoing circumstances, the BANK should not be permitted to amend the Joint Pretrial Order as requested and the Motion is denied.

3. It is clear from the foregoing recital of the relationship between STABRITE and the BANK that plaintiff has established the elements of a voidable preference under B. A. 60a and b (11 U.S.C.96).

4. The BANK seeks to avoid liability under B. A. 60 by asserting that its actions and conduct are protected by the setoff provisions of B. A. 68 (11 U.S.C. 108). It is true that acts and conduct which constitute a valid exercise of the right of setoff

under B. A. 68 do not give rise to a voidable preference. If the transaction is within the scope of §68 it is sheltered from an attack as a preference under §60.

The Bankruptcy Act does not create the right of setoff; it merely recognizes that right when it exists under state or applicable law. B. A. 68 refers to "mutual debts or credits," which "shall be set off against" each other so that "the balance only shall be allowed or paid." Undoubtedly, STABRITE was indebted to the BANK, and the BANK was indebted to STABRITE. Accordingly, the relationship should be characterized, says the BANK, as one involving "mutual debts and credits" which could be set off against each other. Such right of setoff exists under state law (CCP 440) and is, therefore, available to the BANK under B. A. 68.

As the Trustee points out, the right of offset can only be exercised by a bank with respect to funds which were deposited and received by the bank in the ordinary course of business. The Trustee argues that no funds or credits were available at the BANK against which to make its offset until and unless the BANK made the reversing entry of June 18. Accordingly, the Trustee concludes that the funds and credits against which the offset was attempted were not received by the BANK in the ordinary course of business. An understanding and analysis of the Trustee's argument requires a review of some of the evidence and the application thereto of provisions of Article IV of the Commercial Code.

a. Exhibit 1 and testimony with respect thereto indicates that the reversing entry was made between 12 noon and 6 p.m. on June 18. It would appear, however, that the $21,604.75 in checks was received on the 17th or prior. There is no precise evidence as to when the checks were received; however, the evidence is clear that the BANK processed the checks and cleared them for payment prior to the 18th.

b. Commercial Code §4303 provides, in essence, that setoff comes too late if attempted after the happening of the following, or any of them:

i. The cutoff hour (as defined in §4107) has passed, or where no cutoff hour is fixed, the close of business occurs on the day on which the BANK received the checks; or

ii. The bank has become accountable for the items under §4213(1)(d) and §4302.

There is no evidence that the BANK adopted a cutoff hour. However, the evidence sustains the finding that the checks were received and the decision to pay the checks was made on or before the 17th. The setoff was not attempted until the 18th. Moreover, under §4213(1)(d) and §4302 the BANK became accountable to pay the checks when it retained the checks beyond midnight of the day of receipt without (i) settling for the checks, or (ii) returning or paying them, or (iii) sending notice of dishonor. Accordingly, the attempt at setoff came too late.

c. The loss of the right to setoff left the BANK in control of funds or credits which were property of STABRITE. The attempt by the BANK to apply these funds or credits to payment of its own debt invokes the provisions of §60 of the Bankruptcy Act.

5. The BANK disputed the foregoing interpretation of the facts and law. Moreover, it contends that the foregoing discussion is irrelevant. If the right of offset was lost and the BANK was under a legal duty to honor the checks, then the funds and credits under its control were no longer property of STABRITE, and there was no transfer of property of the debtor to which B. A. §60 could apply. The liability of the BANK to the payees of the checks, or to STABRITE, for wrongful dishonor is not an issue.

The BANK position can be summarized as follows:

a. It received funds from STABRITE

b. Checks drawn on these funds by STABRITE were received by the BANK.

c. These checks were subjected to BANK process and procedures, including its "99 hold" procedure and a decision was made to pay the checks. The BANK's books and records were posted to so indicate.

d. Thereafter, the BANK realized that payment of the checks, although now required by law, would deprive the BANK of funds and credits against which to offset its claims against STABRITE and would jeopardize its ability to collect its claims against STABRITE.

e. The BANK thereupon refused to make payment to the payees of the checks (notwithstanding its duty to do so under applicable provisions of the law) and seized the funds and credits for its own advantage.

6. The Trustee asserts that this course of conduct should not receive the legal or equitable sanction of a court of bankruptcy.

I agree. However, it is not necessary to resort to equitable doctrine to manufacture a basis to reject the BANK's position.

The right to offset can only be exercised by a bank against funds or deposits received in the ordinary course of business. While the deposit made by STABRITE was intially so received, the BANK lost its right to setoff with respect to these funds and credits. Under California law, the BANK was required to make payment to the payees of the checks and became accountable to the payees and to STABRITE for its failure to do so. It was only after the attempt at setoff through the device of the reversing entry that the BANK realistically, and according to its own books and records, had funds or credits available against which to accomplish the setoff. The creation, or perhaps more

accurately the re-creation of the res against which setoff was attempted, did not occur in the ordinary course of business. It was artfully designed and accomplished by the BANK with intent to gain an advantage over other creditors of STABRITE who were not in a position to contest the issue and to whom the BANK owed a duty under law inconsistent with the course of action the BANK elected to pursue.

The funds and credits in the possession of and under the control of the BANK on June 18th were property of the debtor and the seizure thereof by the BANK was a transfer within the contemplation of §60 of the Bankruptcy Act. The argument of the BANK to avoid this result, based upon the provisions of California law dealing with the relationship between depositor, payee and bank, is unavailing. It is true that the term "property" is not susceptible of a precise or universal definition. However, the determination of whether a given res is "property" for the purpose of applying the provisions of the Bankruptcy Act is a matter of Federal law and must be resolved in accordance with the Federal policy considerations embodied in the Bankruptcy Act. [*Kokoszka v. Belford* (1974) 417 U. S. 642; *Segal v. Rochell* (1965) 382 U. S. 375; and *Chicago Board of Trade vs. Johnson* (1924) 264 U. S. 1]. The Commercial Code provisions dealing with the right to setoff do not preclude the Federal court from determining that the funds and credits subject to the BANK's possession and control were "property" of STABRITE and as such were protected against voidable transfers, as defined in the Bankruptcy Act.

The BANK points out that subsequent to June 18 and prior to the date of bankruptcy the BANK cleared and paid an additional $12,143.69 in checks issued by STABRITE to various payees. No credits or funds of STABRITE were on hand at the BANK for use in paying these checks. The BANK seeks a credit, or offset, in the amount of these payments against any judgment awarded to the Trustee in these proceedings.

There is no evidence in the record with respect to any of the following:

1. The facts or circumstances relating to the issuance of these checks, the date of their receipt by the BANK, the periods of time during which they were held and processed by the BANK, the nature of the claims of the payees involved; or

2. Why the BANK paid the checks, or what funds the BANK intended to utilize in doing so; or

3. The existence of any duty or obligation on the part of the BANK to make such payments.

Moreover, the BANK has suggested no legal theory which supports its claim for credit or offset, nor has it cited any authorities which would support the allowance of such credit or offset. It would appear, therefcre, that the BANK's only relief in this regard would be the filing of a Proof of Claim in the proceedings, to the extent that such relief is available under appropriate provisions of the Bankruptcy Act.

CONCLUSION

1. The seizure by the BANK of funds and credits of STABRITE in its possession on June 18, in the sum of $21,604.75 and $427.09, an aggregate of $22,031.84, is and constitutes a voidable preference.

2. The Trustee is entitled to judgment in the amount of $22,031.84, plus interest thereon at the legal rate since June 18, 1971.

This Decision shall constitute Findings of Fact and Conclusions of Law, as provided in Rule 52(a).

Dated: January 23, 1971.

/s/ Robert L. Ordin

ROBERT L. ORDIN, Special Master

ENTERED
MAY 15, 1979
Clerk, U.S. District Court
Central District of California
By Deputy

FILED
MAY 14, 1979
Clerk, U.S. District Court
Central District of California
By Deputy

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

TERRANCE P. GOGGIN, as Trustee for STABRITE POOLS, INC., a California corporation, Bankrupt,

Plaintiff.

vs.

LINCOLN BANK, a California corporation,

Defendant.

No. 72-1766-AAH

JUDGMENT

The within cause having been referred by this Court to a Special Master to determine the issues of fact and law, by Order filed November 15, 1974; and the matter having proceeded through discovery, motion and pretrial procedures before the Special Master, and the cause having been tried before the Special Master on June 6, June 7, June 8, June 13, June 14 and June 15, 1977, and the Special Master having filed his Report and Recommendation in accordance with the provisions of Rule 53(e); and the parties having received notice of the filing of the Report of the Special Master, and Objections to the Report and Recommendation of the Special Master having been filed by defendant LINCOLN BANK; and a hearing on said Report having been noticed and held on May 14, 1979, plaintiff, Trustee for STABRITE POOL STORES, INC., a California corporation, having appeared through its counsel, BUCHALTER, NEMER, FIELDS & CHRYSTIE, by Elihum Berle, Esq., and LINCOLN BANK, a California corporation,

and defendant having appeared through its counsel, GENDEL, RASKOFF, SHAPIRO & QUITTNER, by Richard Berger, Esq.; and the Court having read and considered the files, records and proceedings in this matter and the record of the proceedings and evidence before the Special Master and the Report and Recommendations of the Special Master. And the Court having determined that the Report and Recommendation of the Special Master and his Amended Decision with respect to the facts and law of this case are fully supported by the record in these proceedings; and that the Amended Decision of the Special Master is and constitutes Findings of Fact and Conclusions of Law, as provided in Rule 52(a); and that said Findings of Fact and Conclusions of Law are certainly not clearly erroneous and therefore should be and are adopted by this Court; NOW, THEREFORE, pursuant to the aforesaid Findings of Fact and Conclusions of Law,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED AS FOLLOWS:

1. Plaintiff shall have and recover of and from defendant the sum of $22,031.84, together with interest thereon at the legal rate since June 18, 1971; and

2. Plaintiff shall have and recover its costs of suit against defendant, which costs are hereby taxed in the sum of $ .....

3. The Clerk is directed to enter this Judgment and serve copies thereof on counsel for all parties herein and the aforesaid Special Master.

DATED: May 14, 1979

/s/ A. Andrew Hauk

A. ANDREW HAUK
UNITED STATES DISTRICT JUDGE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

TERRENCE B. GOGGIN, as Trustee of STABRITE POOL STORES, INC., a California corporation, Bankrupt,

Plaintiff-Appellee,

v.

LINCOLN BANK, a California corporation,

Defendant-Appellant.

FILED
MAY 26, 1981
RICHARD H. DEANE
CLERK, U.S. COURT OF APPEALS

No. 79-3360
D.C. 72-1766-AAH

MEMORANDUM

Appeal from the United States District Court for the Central District of California

A. Andrew Hauk, District Judge Presiding Argued and submitted April 9, 1981

Before TUTTLE*, CHOY and KENNEDY, Circuit Judges:

The Bank appeals from a judgment of the district court, following finding of fact and conclusions of law submitted by a court appointed special master requiring repayment by it of $22,031.84 which it had received as voidable preferences from a bankrupt.

Following several months of financial difficulties, during which the Bank had agents supervising the operations of the company, Stabrite ceased doing business on the morning of June 18, 1971. On June 24, the corporation filed a petition in bankruptcy. This filing was preceded by some unusual flurries by the Bank's bookkeepers. Significant to this litigation are the following:

* The Honorable Elbert P. Tuttle, Senior Circuit Judge, U.S. Court of Appeals, Fifth Circuit, sitting by designation.

1. Prior to June 18, Stabrite had issued $21,604.75 of checks on its general account and $427.09 on its payroll account. There were funds on hand to pay these checks and the checks had been deposited by their respective payees and they had passed through the clearing system and had been posted to Stabrite's accounts so as to debit them in the amount of $22,031.84. The approximately 42 checks totalling $21,604.75 were all posted at least 24 hours before June 17, 1971 and the eight checks totalling $427.09 were posted to the Stabrite account on June 21, 1971.

2. On June 18, 1971, the Bank reversed entries totalling $21,604.75 on Stabrite's general account and recredited Stabrite's account with the face amount of these checks.

3. On June 22, 1971, the Bank reversed entries indicating payment of $427.09 of checks drawn on the payroll account and recredited that account with the face amount of these checks.

4. On June 23, 1971, the Bank withdrew the full amount of these two redeposits and applied it against Stabrite's promissory note which was held by the Bank.

After Stabrite filed for bankruptcy, the payees of $12,143.69 of the dishonored checks demanded payment from Lincoln Bank. The Bank claims to have made these payments to its customers and it added this amount back to Stabrite's loan obligation.

Upon filing of an action by Stabrite's trustee, claiming that Lincoln's application of the $22,031.84 was a voidable preference, the trial court referred the entire case to its special master, who was also the bankruptcy judge for the district. The special master filed his findings of fact and conclusions of law favoring the trustee, and the Bank appeals.

Appellant's first attack is upon the referring of the case by the trial court to a special master. We agree that such reference is controlled by Rule 53(b) of the Federal Rules of Civil

procedure. This Court has held; "This was a matter for the district judge's determination in light of his perception of whether the jury would find the issue complicated." *Crateo, Inc. v. Intermark, Inc.*, 536 F.2d 862 (9th Cir. 1976). Because the trial court could properly find this state of facts to be "complicated" within the concept of *Crateo* and in light of the clearly questionable conduct by the Bank, clearly shown on the record before the trial court, we do not think it appropriate to second guess the judge's exercise of his discretion in this matter.

The Bank seeks to justify its transfer to itself just prior to bankruptcy of the funds which appeared in the account of the bankrupt on the theory that this was a setoff of the deposits against the loan indebtedness represented by the bankrupt's promissory note. The Bank did not contest the trustee's argument that such an offset can be made only where the fund is created in good faith, which the special master found was not the case here. It proceeds rather on the argument that it could not be guilty of receiving a voidable preference because what purported to be bank balance belonging to Stabrite was not really "property" of the bankrupt. In other words, "things are not what they seem." Longfellow, *The Psalm of Life*, St. 2 (1839).

This position of the Bank must fail, because it could not use a deposit as a setoff against the bankrupt's indebtedness to it unless the amount setoff was the property of the bankrupt. Whether these funds became the property of the bankrupt by the voluntary act of the Bank in replacing the amount in the bankrupt's account, or whether we conclude that the Bank will simply not be heard to contend that what it purported to treat as the bankrupt's property was not its property at all is unimportant. It treated the amount as the property of Stabrite when it set it off against Stabrite's indebtedness. It cannot now contend to the contrary.

We have considered the other grounds of appeal and find them without merit.

The judgment is AFFIRMED.

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

TERRENCE B. GOGGIN, as Trustee of STABRITE POOL STORES, INC., a California corporation, Bankrupt,

Plaintiff-Appellee,

v.

LINCOLN BANK, a California corporation,

Defendant-Appellant.

FILED
JULY 13, 1981
RICHARD H. DEANE
CLERK, U.S. COURT OF APPEALS

No. 79-3360

MEMORANDUM

On Petition for Rehearing and Suggestion of Appropriateness of Rehearing En Banc

Before TUTTLE,* CHOY and KENNEDY, Circuit Judges.

This memorandum disposition heretofore entered in this case is withdrawn and the following is substituted for it.

The Bank appeals from a judgment of the district court, following findings of fact and conclusions of law submitted by a court appointed special master requiring repayment by it of $22,031.84 which it had received as voidable preferences from a bankrupt.

Following several months of financial difficulties, during which the Bank had agents supervising the operations of the company, Stabrite ceased doing business on the morning of June 18, 1971. On June 24, the corporation filed a petition in bankruptcy. This filing was preceded by some unusual flurries by the Bank's bookkeepers. Significant to this litigation are the following.

* The Honorable Elbert P. Tuttle, Senior Circuit Judge, U.S. Court of Appeals, Fifth Circuit, sitting by designation.

1. Prior to June 18, Stabrite had issued $21,604.75 of checks on its general account and $427.00 on its payroll account. There were funds on hand to pay these checks and the checks had been deposited by their respective payees and they had passed through the clearing system and had been posted to Stabrite's accounts so as to debit them in the amount of $22,031.84. The approximately 42 checks totalling $21,604.75 were all posted at least 24 hours before June 17, 1971 and the eight checks totalling $427.09 were posted to the Stabrite account on June 21, 1971.

2. On June 18, 1971, the Bank reversed entries totalling $21,604.75 on Stabrite's general account and recredited Stabrite's account with the face amount of these checks.

3. On June 23, 1971, the Bank withdrew the full amount of these two redeposits and applied it against Stabrite's promissory note which was held by the Bank.

After Stabrite filed for bankruptcy, the payees of $12,143.69 of the dishonored checks demanded payment from Lincoln Bank. The Bank claims to have made these payments to its customers and it added this amount back to Stabrite's loan obligation.

Upon filing of an action by Stabrite's trustee, claiming that Lincoln's application of the $22,031.84 was a voidable preference, the trial court referred the entire case to its special master, who was also the bankruptcy judge for the district. The special master filed his findings of fact and conclusions of law favoring the trustee, and the Bank appeals.

Appellant's first attack is upon the referring of the case by the trial court to a special master. We agree that such reference is controlled by Rule 53(b) of the Federal Rules of Civil Procedure. This Rule provides:

> A reference to a master shall be the exception and not the rule. In actions to be tried . . . without a jury, save in matters of account and of difficult computation of damages, a reference shall be made only upon a showing that some exceptional condition requires it.

This, of course, is a "matter of account" in that it involves a nine count complaint by the trustee in bankruptcy involving a large number of transactions between the bankrupt and the Bank. It is also a matter "of difficult computation of damages" because of the very unusual circumstance made apparent on the record before the trial court. These are that *Lincoln Bank was relying upon its own conversion of funds which it concedes belonged to other creditors of the bankrupt* in order to set up funds in the account of the bankrupt which it could then offset by its claim on a promissory note. This effort by the Bank to use funds actually belonging to payees of checks written by Stabrite to create a fund which it could then use as a partial offset against Stabrite's note was characterized by the special master in the following terms:

> The creation, or perhaps more accurately, the recreation of the res against which setoff was attempted, did not occur in the ordinary course of business. It was artfully designed and accomplished by the bank with intent to gain an advantage over other creditors of Stabrite's. . . .

We conclude that the matter referred to the special master here was such as could be considered by the trial court in its descretion as one of "account and difficult computation of damages" and thus within the contemplation of Rule 53(b). As to the discretion of the trial court in making such a reference, *see American Cyanamid Co. v. Ellis-Folster Co.*, 298 F. 2d 244, 247 (3rd Cir. 1962); *Southern Agency Co. v. LaSalle Casualty Co*, 393 F.2d 907, 914 (8th Cir. 1968), both decided after *LaBuy v. Hawes Leather Co.*, 352 U.S. 249 (1956).

The Bank seeks to justify its transfer to itself the funds which appeared in the account of the bankrupt on the theory that this was a setoff of the deposits against the loan indebtedness represented by the bankrupt's promissory note. The Bank proceeds on the argument that it could not be guilty of receiving a voidable preference because what purported to be a bank balance belonging to Stabrite was not really "property" of the bankrupt. In other words, "things are not what they seem." Longfellow, *The Psalm of Life*, St. 2. (1939).

This position of the Bank must fail, because it could not use a deposit as a setoff against the bankrupt's indebtedness to it unless the amount set off was the property of the bankrupt. The Bank, in its brief to this Court, takes the amazing position that the $22,031.84 which it caused to be entered to Stabrite's account was not Stabrite's money but was money belonging to the 42 payees of the checks drawn in their favor by Stabrite. The Bank thus boldly confesses to having converted the funds of the payees to its own use which funds, it says, continued to be the property of the payees even after the Bank had credited the amount to Stabrite's account. The Bank does not suggest any legal principle upon which this Court could find that because it appropriated the funds of third parties and then placed a similar amount in Stabrite's account, the amount in the bankrupt's account still represented the same funds that the Bank had appropriated. Whether these funds became the property of the Bankrupt by the voluntary act of the Bank in replacing the amount in the bankrupt's account, or whether we conclude that the Bank will simply not be heard to contend that what it purported to treat as the bankrupt's property in order to make the setoff was not its property at all is unimportant. It treated the amount as the property of Stabrite when it set it off against Stabrite's indebtedness. It cannot now contend to the contrary.

We have considered the other grounds of appeal, including that of the Bank claiming that if the trustee should prevail he should not be permitted to recover the approximately $12,000 which the Bank says it has had to pay off to customers whose accounts were debited when the Bank illegally dishonored Stabrite's checks to them. It is of no concern to the trustee that the Bank has seen fit to refund approximately half of the money it illegally took from the third party payees. Lincoln Bank is still so far, as disclosed by the record, in possession of some $10,000 which it has taken from those of its depositors who did not demand repayment of the amounts of the dishonored checks.

We find the other grounds of appeal without merit. The judgment is AFFIRMED.

The petition for rehearing is DENIED.

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

TERRENCE B. GOGGIN, as Trustee of STABRITE POOL STORES, INC., a California corporation, Bankrupt, *Plaintiff-Appellee,* v. LINCOLN BANK, a California corporation, *Defendant-Appellant.*	**FILED** **AUGUST 5, 1981** **RICHARD H. DEANE** **CLERK, U.S. COURT OF APPEALS** **No. 79-3360** **ORDER**

Before: TUTTLE*, CHOY and KENNEDY, Circuit Judges

The panel as constituted in the above case voted to deny the petition for rehearing and to reject the suggestion for rehearing en banc.

On July 13, 1981 the original disposition was withdrawn and a revised Memorandum was filed, which included a statement that the petition for rehearing was denied.

The full court has been advised of the suggestion for rehearing en banc and no judge of the court has voted to grant rehearing en banc. F.R.App.P. 35(b).

The suggestion for rehearing en banc is rejected.

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* The Honorable Elbert P. Tuttle, Senior Circuit Judge, U.S. Court of Appeals, Fifth Circuit, sitting by designation.

Rule 53(b), Federal Rules of Civil Procedure:

Reference. A reference to a master shall be the exception and not the rule. In actions to be tried by a jury, a reference shall be made only when the issues are complicated; in actions to be tried without a jury, save in matters of account and of difficult computation of damages, a reference shall be made only upon a showing that some exceptional condition requires it.

11 U.S.C. § 96(a) [Section 60a(1) of the Bankruptcy Act of 1898):

Preferred Creditors. (a)(1) A preference is a transfer, as defined in this title, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this title, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.

11 U.S.C. 108a [Section 68a of the Bankruptcy Act of 1898]:

Set-offs and counterclaims. a. In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid.